

10/10/2013

THE ITALIAN OBG MARKET

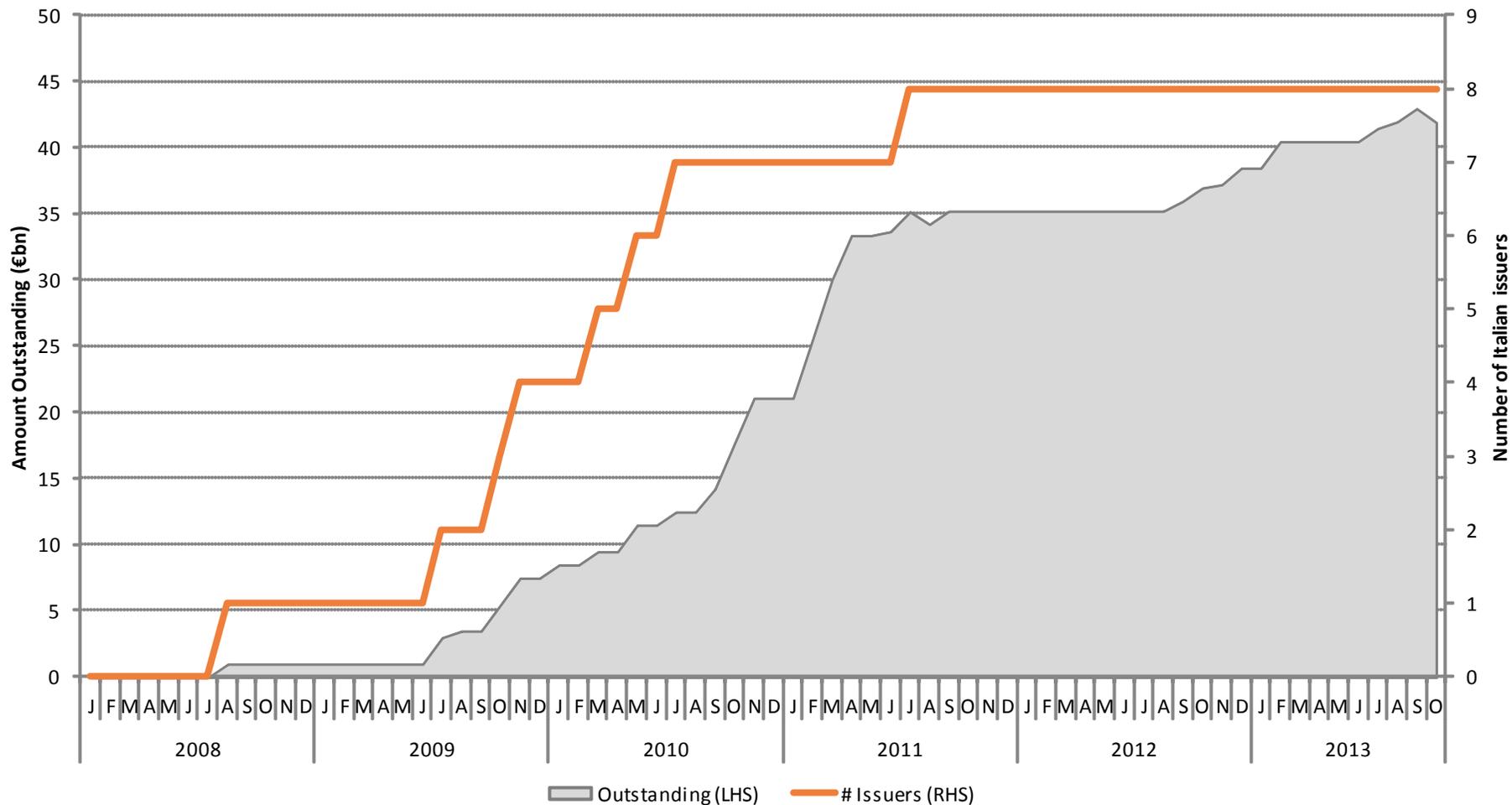
BUILDING TEAM SPIRIT TOGETHER



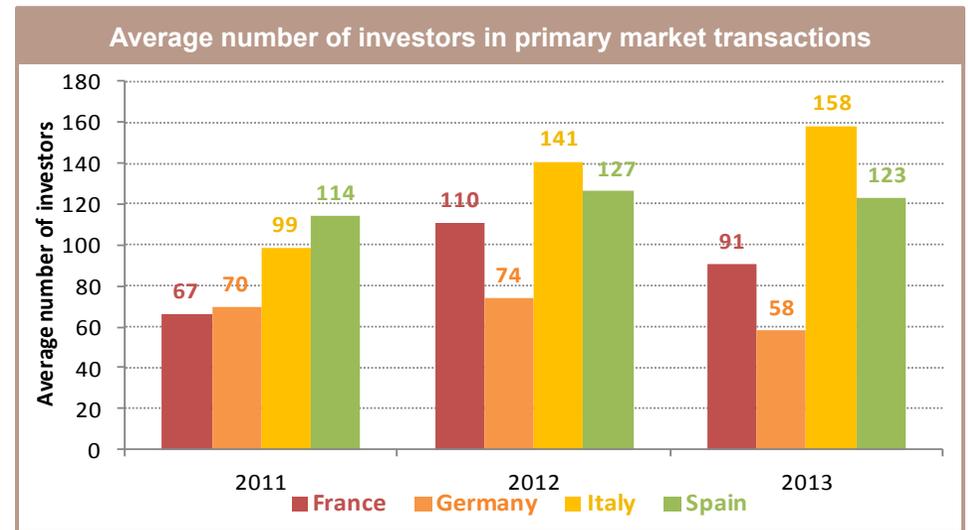
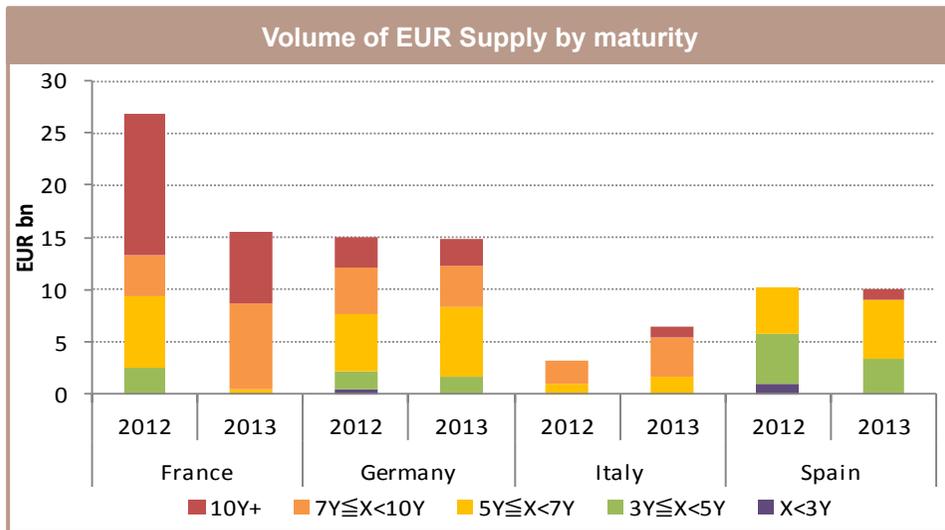
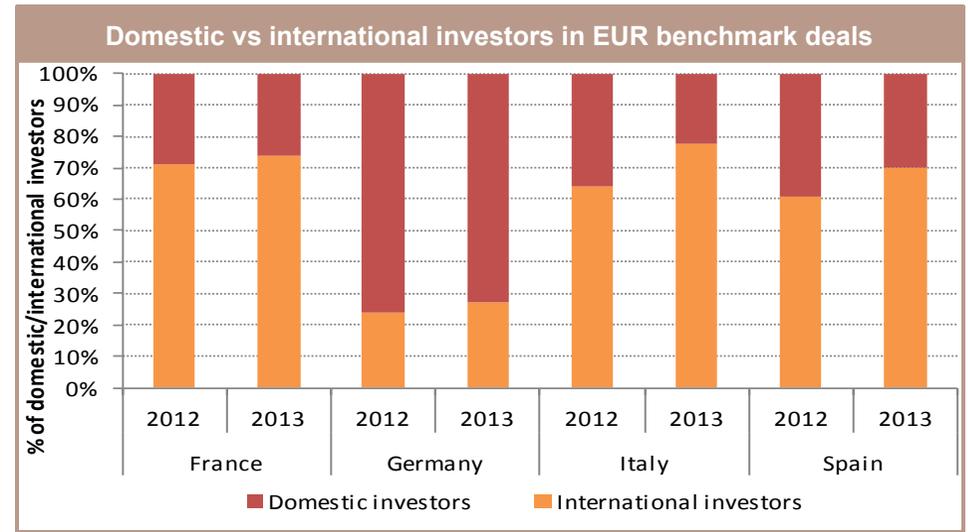
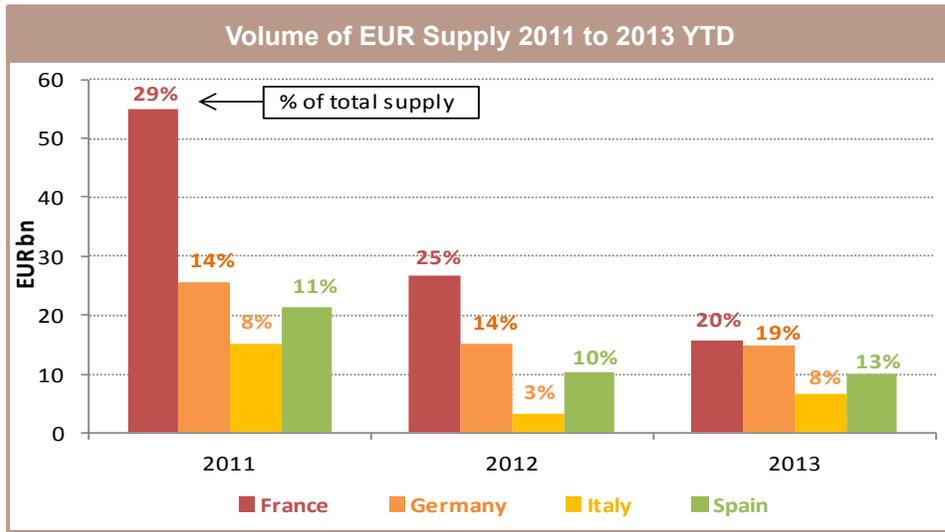
SOCIETE GENERALE
Corporate & Investment Banking

5 YEARS OF ITALIAN OBG MARKET – A SUCCESS STORY

Evolution of Italian Outstanding Italian OBG Benchmark Covered Bonds and number of issuers

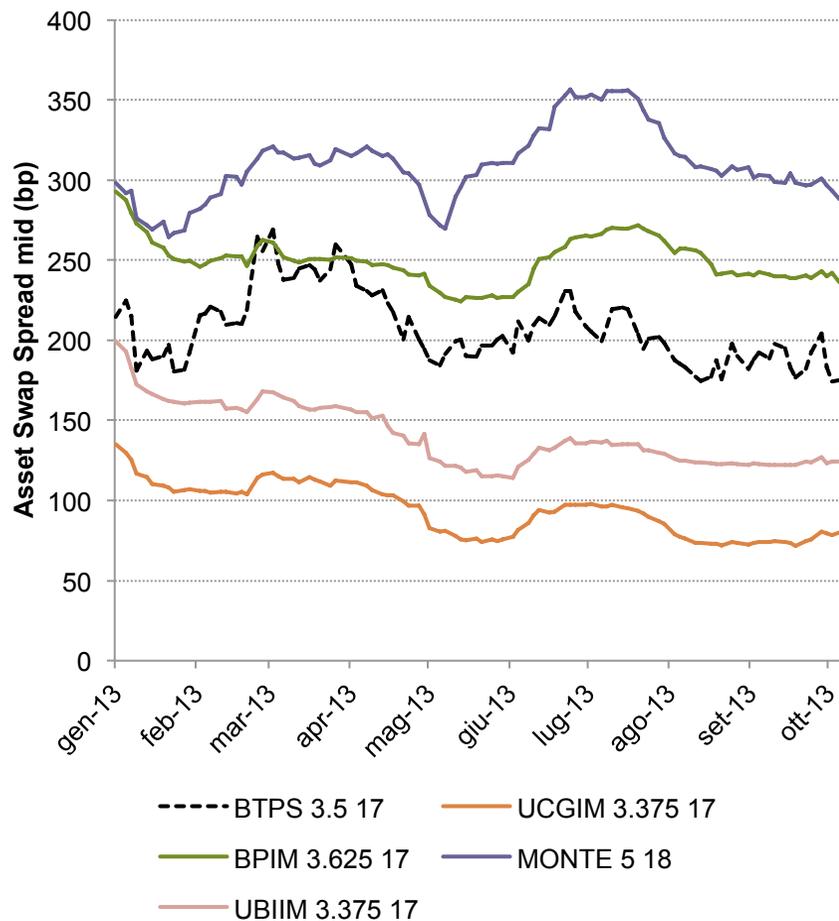


SUPPLY AND INVESTOR DEMAND PATTERN FOR MAJOR COVERED BOND MARKETS

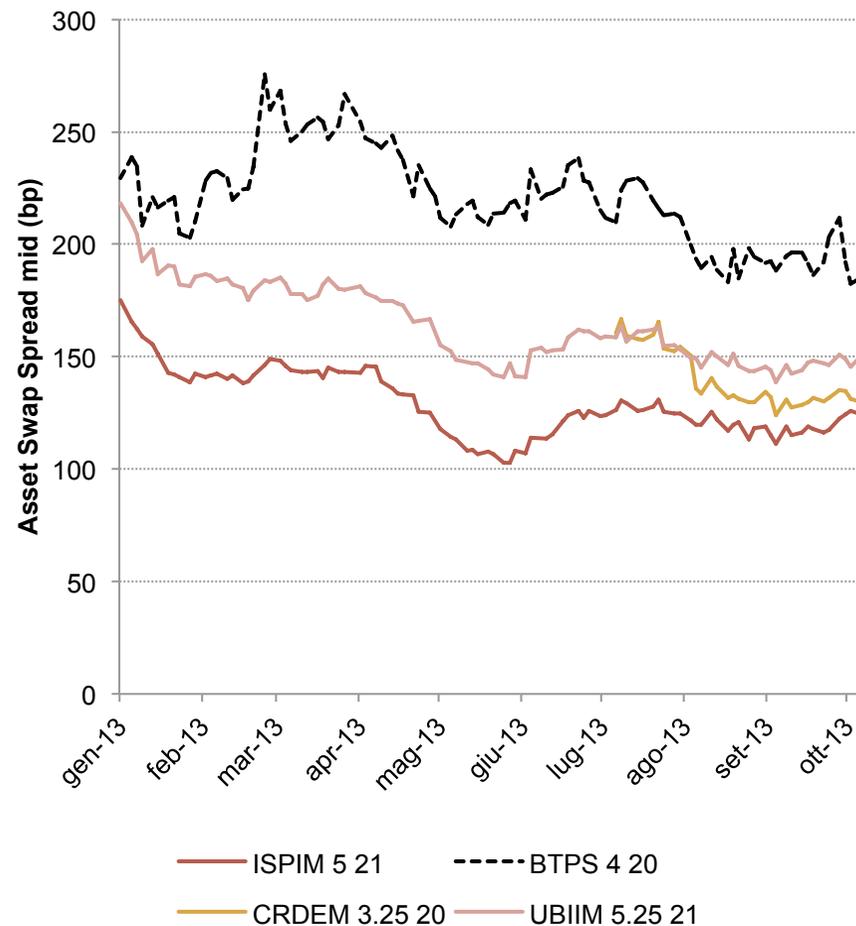


OBG MARKET SECONDARY SPREAD DEVELOPMENTS SINCE START OF 2013

Intermediate tenor (2017-2018)



Longer tenor (2020)





ECB COLLATERAL RULES AND HAIRCUTS FOR COVERED BONDS AND ABS

Recent Modifications and Implications

ECB REPO CRITERIA REMAIN MORE FAVORABLE FOR COVERED BONDS THAN FOR ABS

Latest amendments point to a more balanced treatment, but still a long way to go....

Over the past 12 months, the ECB has modified several times the repo eligibility criteria for covered bonds and ABS

The main changes on the **covered bond** side were:

■ **28th Nov 2012:**

- Removal of eligibility of covered bonds with non-self originated ABS tranches in the cover pool (2 Y grandfathering for existing covered bonds)
- Close-link exemption limited to CRD-compliant covered bonds and UCITS-compliant covered bonds which offer comparable protection to CRD criteria

■ **18th July 2013:**

- Downward revision of haircuts for non-retained covered bonds between 0.5 and 3 pct points (see table page 6) – only exception are Jumbo covered bonds over 10years
- Introduction of an additional valuation markdown for retained covered bonds: 8% if covered bond rated AAA to A-, 12% if rated BBB+ to BBB-

The main changes on the **ABS** side were:

■ **20th Mar 2013:**

- ABS tranches with min 2 Triple-B ratings at issuance to be accepted under the ECB temporary collateral framework (haircut for CMBS 32%, other ABS: 26%)

■ **18th July 2013:**

- ABS tranches with min 2 Single-A ratings at issuance to be accepted under the ECB permanent collateral framework (previously 2 Triple-A)
- Downward revision of haircuts for ABS eligible under the permanent and temporary ECB collateral framework (see table page 6)

However, covered bonds keep a far more favorable treatment as primarily reflected by the following features:

- Covered bonds eligible in permanent framework down to BBB- rating and first-best rule (i.e. the best rating) applies while ABS only eligible permanently down to A- rating with second-best rule applying
- All haircuts for covered bond remain lower than for ABS of same rating category and for variable coupon covered bonds the haircuts of the 0-1Y maturity buckets are applied (see some examples on following pages)
- Retained or „own-use“ covered bonds means covered bonds used in a percentage greater than 75% of the outstanding notional by the issuer or closed linked entities
- Requirement of loan-level data provision for ABS transactions

NEW ECB REPO HAIRCUT GRID & CHANGES TO PREVIOUS GRID

ABS, Triple-B Senior Debt and traditional covered bonds benefit the most

ECB Haircut Schedule

from 18.July 2013

Credit Quality Steps 1 and 2 (AAA to A-)	Liquidity category I		Liquidity category II		Liquidity category III		Liquidity category IV		Liquidity category V	
	Central govt debt and debt issued by central banks	Local, regional govt debt, jumbo covered bonds, agency and supra debt	Traditional, structured, multi-cedulas covered bonds, corporate debt and	uncovered credit institution debt	Asset-backed securities					
residual maturity (years)	Fixed coupon	Abs pct change to previous grid	Fixed coupon	Abs pct change to previous grid	Fixed coupon	Abs pct change to previous grid	Fixed coupon	Abs pct change to previous grid	All coupons	Abs pct change to previous grid
0-1	0.5	0.0	1.0	0.0	1.0	-0.5	6.5	0.0	10.0	-6.0
1-3	1.0	-0.5	1.5	-1.0	2.0	-1.0	8.5	0.0	10.0	-6.0
3-5	1.5	-1.0	2.5	-1.0	3.0	-2.0	11.0	0.0	10.0	-6.0
5-7	2.0	-1.0	3.5	-1.0	4.5	-2.0	12.5	0.0	10.0	-6.0
7-10	3.0	-1.0	4.5	-1.0	6.0	-2.5	14.0	0.0	10.0	-6.0
>10	5.0	-0.5	8.0	0.5	9.0	-2.0	17.0	0.0	10.0	-6.0

Credit Quality Steps 3 (BBB+ to BBB-)	Liquidity category I		Liquidity category II		Liquidity category III		Liquidity category IV		Liquidity category V	
	Central govt debt and debt issued by central banks	Local, regional govt debt, jumbo covered bonds, agency and supra debt	Traditional, structured, multi-cedulas covered bonds, corporate debt and	uncovered credit institution debt	Asset-backed securities					
residual maturity (years)	Fixed coupon	Abs pct change to previous grid	Fixed coupon	Abs pct change to previous grid	Fixed coupon	Abs pct change to previous grid	Fixed coupon	Abs pct change to previous grid	All coupons	Abs pct change to previous grid
0-1	6.0	0.5	7.0	1.0	8.0	0.0	13.0	-2.0	22.0	CMBS: -10%, Other: -4%
1-3	7.0	0.5	10.0	-0.5	15.0	-3.0	24.5	-3.0	22.0	CMBS: -10%, Other: -4%
3-5	9.0	1.5	15.5	0.0	22.5	-3.0	32.5	-4.0	22.0	CMBS: -10%, Other: -4%
5-7	10.0	2.0	16.0	-2.0	26.0	-2.0	36.0	-2.5	22.0	CMBS: -10%, Other: -4%
7-10	11.5	2.5	18.5	-1.0	27.0	-1.0	37.0	-2.0	22.0	CMBS: -10%, Other: -4%
>10	13.0	2.5	22.5	2.5	27.5	-2.0	37.5	-2.0	22.0	CMBS: -10%, Other: -4%

IMPACT OF HAIRCUT REDUCTION FOR NON-RETAINED COVERED BONDS AND ABS

Some examples - see full grid on page 6

	NEW	OLD	NEW	OLD	NEW	OLD	NEW	OLD
Type of instrument	Trad. Covered bond (LC III)	Trad. Covered bond (LC III)	ABS	ABS	Trad. Covered bond (LC III)	Trad. Covered bond (LC III)	ABS (RMBS)	ABS (RMBS)
Coupon	fixed	fixed	n.a.	n.a.	fixed	fixed	n.a.	n.a.
Rating	A-	A-	A-	A-	BBB-	BBB-	BBB-	BBB-
Residual Maturity	5Y	5Y	n.a.	n.a.	3Y	3Y	n.a.	n.a.
Market valuation available	Y	Y	Y	Y	Y	Y	Y	Y
Retained covered bond	N	N	n.a.	n.a.	N	N	n.a.	n.a.
Haircut calculation								
ECB haircut schedule	4.50%	6.50%	10.00%	16.00%	22.50%	25.50%	22.00%	26.00%
Markdown for theoretical valuation	-	-	-	-	-	-	-	-
markdown for retained covered bond	-	-	-	-	-	-	-	-
Total haircut	4.50%	6.50%	10.00%	16.00%	22.50%	25.50%	22.00%	26.00%

- For non-retained secured debt instruments with a rating minimum of A-, covered bonds continue to benefit from the lowest haircut. Comparable ABS tranches have a haircut which is twice as high (example in column 1-4). **There is still no incentive from haircut point of view to switch from covered bond holdings to ABS holdings, but at least the gap gets closer which could be of interest when looking into the risk-reward for ABS secured by assets which are non-standard for covered bonds (e.g. SME loans).**
- Interestingly, a Triple B rated ABS tranche (only eligible under the temporary framework) will now have a haircut of 22% (see ①), which is slightly lower than the haircut of a BBB rated fixed-rate covered bond with a residual maturity of 3 years (see ②). However, while there is a market for Triple-B covered bonds (at least temporarily), there is no for similar rated ABS. Taking into account that depending on structuring and rating approach (in particular on the potential to get close or even pierce country ceilings), ABS could achieve higher ratings than covered bonds with same cover assets. As a result, there could be some cases where issuers could prefer the issuance of ABS instead of covered bonds.

IMPACT ON RETAINED INSTRUMENTS

Some examples - see full grid on page 6

	NEW	OLD	NEW	OLD	NEW	OLD	NEW	OLD
Type of instrument	Trad. Covered bond (LC III)	Trad. Covered bond (LC III)	ABS	ABS	Trad. Covered bond (LC III)	Trad. Covered bond (LC III)	ABS (RMBS)	ABS (RMBS)
Coupon	fixed	fixed	n.a.	n.a.	floating	floating	n.a.	n.a.
Rating	A-	A-	A-	A-	BBB-	BBB-	BBB-	BBB-
Residual Maturity	3Y	3Y	n.a.	n.a.	3Y	3Y	n.a.	n.a.
Market valuation available	Y	Y	N	N	N	N	N	N
Retained	Y	Y	Y	Y	Y	Y	Y	Y
Haircut calculation								
ECB haircut schedule	3.00%	5.00%	10.00% ³	16.00%	8.00%	8.00%	22.00%	26.00%
Markdown for theoretical valuation	-	-	5%	5%	5%	5%	5%	5%
markdown for retained covered bond	8% ¹	-	- ²	-	12% ⁴	-	- ⁵	-
Total haircut	10.76%¹	5.00%	14.50%²	20.20%	23.09%⁴	12.60%	25.90%⁵	29.70%

Retained covered bonds are usually designed in two ways in order to minimise haircuts:

1. Tap of a fixed rate covered bond of which the initial tranche was sold to investors, market valuation available (column 1-4): For this option, the introduction of the markdown for retained covered bonds leads to a significant increase in haircut (doubles in our example – see ❶). For a fully retained ABS with similar rating, there is a significant drop in the total haircut (see ❷). **If the ABS tranche can be partially sold to the market and get a market valuation, the haircuts for the retained parts of ABS and covered bonds are almost the same (see ❸).**
2. Issuance of a new floating rate covered bond (= haircut of the 0-1Y class), theoretical valuation (column 5-8): For this option, the retained covered bond haircut leads to a total haircut (see ❹) which is now almost as high as for a similar ABS transaction (see ❺)

Depending on other costs (OC to reach a certain rating, documentation costs, etc...) and other considerations (e.g. asset encumbrance) it could make sense to use ABS more often for retained transactions under the new ECB haircut scheme